In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 71-1557

NATIONAL SURETY CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinions of the Court of Claims (Pet. App. 13-16) are not reported.

JURISDICTION

The judgment of the Court of Claims was entered on October 29, 1971, and a petition for rehearing was denied on March 17, 1972. The petition for a writ of certiorari was filed on May 30, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Whether federal tax claims against a defaulting contractor may be satisfied out of unpaid contract funds retained by the government pursuant to the terms of the construction contract prior to any disbursement to the contractor's payment bond surety.

STATUTES INVOLVED

The pertinent provisions of Section 6323 of the Internal Revenue Code of 1954, 26 U.S.C. 6323, are set forth at Pet. 2-4.

STATEMENT

Petitioner is the payment bond surety of the Glacier Construction Company, which in January 1967 entered into a contract with the Federal Highway Administration to do work on a government highway construction project in Alaska. The Highway Administration was authorized to retain a percentage of the amounts accrued under the contract; these retainages were to be paid to Glacier upon completion and acceptance of the work contracted for and payment of all claims for labor and materials used by Glacier in the project. In connection with the letting of the contract, petitioner executed two surety bonds. One bond guaranteed performance of the contract; the other guaranteed payment to all persons supplying Glacier with labor and material.

Prior to its completion of the contract, Glacier defaulted on its obligations to certain suppliers and

workmen. Thereafter, petitioner, pursuant to its payment bond, paid claims of labor and materialmen aggregating about $126,000.[1] After petitioner commenced payment of these claims, but before all the moneys were disbursed, the Internal Revenue Service ("IRS") filed tax liens against Glacier for slightly more than $96,000. Notice of the liens was served upon the Highway Administration, which then held approximately $79,000 in retainage funds due to Glacier under the contract. The Highway Administration paid these funds to IRS.

Alleging that its interest in the retained funds was superior to the interest asserted by IRS, petitioner filed a petition in the Court of Claims, pursuant to 28 U.S.C. 1491, seeking a judgment against the United States for $78,534.89, representing the contract money retained by the government. On the government's motion, the Court of Claims dismissed the suit.

ARGUMENT

1. In upholding the right of the United States to apply funds it has retained under a government contract to satisfy the contractor's federal tax liability, the Court of Claims properly followed and applied *United States* v. *Munsey Trust Co.*, 332 U.S. 234. Contrary to petitioner's contention (Pet. 6-8), the

[1] While Glacier defaulted on these payments, it did complete performance of the contract. Accordingly, only the payment bond is in issue here.

dispositive holding of that case was not altered or weakened by *Pearlman* v. *Reliance Ins. Co.*, 371 U.S. 132.

Munsey Trust was a suit by the receiver of a government contractor, acting for the benefit of a contractor's surety who had paid the contractor's laborers and materialmen. The receiver sought to recover the amounts retained by the government under the contract. The government had applied part of the retained funds as a setoff against another claim it had against the contractor. The Court of Claims held that the receiver was entitled to the retainages for disbursement to the surety. This Court reversed, applying the settled principle that "[t]he government has the same right 'which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due to him'." 332 U.S. at 239. See also, *Barrett* v. *United States*, 367 F. 2d 834 (Ct. Cl.).

The *Pearlman* case involved a different situation. The question there was whether a payment bond surety's subrogated rights to funds retained by the government were superior to the rights of the contractor's trustee in bankruptcy, to whom the government had disbursed the funds. The government was a mere stakeholder and was not a party to the suit. In holding that the surety was entitled to recover from the trustee the amount representing the funds retained by the government, the Court noted (371 U.S. at 139) that the surety has a "right to subro-

gation in such a fund whether its bond be for performance or payment."

Thus, *Pearlman* did not involve the question of the government's right to set off tax claims against contract creditors, nor did it affect the long-standing rule of *Munsey Trust*. Furthermore, the Court in *Pearlman* referred to *Munsey Trust* without in any way questioning its continued vitality. In considering the interrelationship of these two cases, the Fifth Circuit in *Trinity Universal Insurance Co.* v. *United States*, 382 F. 2d 317, certiorari denied, 390 U.S. 906, properly concluded (at 320):

> In Pearlman v. Reliance Insurance Co., 1962, 371 U.S. 132, 138, 83 S. Ct. 232, 236, 9 L. Ed. 2d 190, the Supreme Court recognized the well-established doctrine that "a surety who completes a contract has an 'equitable right' to indemnification out of a retained fund." *Munsey* did not disturb this rule, for as the Court noted in *Pearlman*:
>
> > "We held that the Government could exercise the well-established common-law right of debtors to offset claims of their own against their creditors. This was all we held. * * * We hold that *Munsey* left the rule in *Prairie Bank* and *Henningsen* undisturbed." 371 U.S. at 140, 141, 83 S. Ct. at 237.
>
> The rights of the surety in *Munsey* were those of a subrogee of the contractor. Whoever, be it the contractor or his surety, pays the laborers and materialmen would be a creditor of the gov-

ernment insofar as the retained funds are concerned. *Pearlman* at p. 141, 83 S. Ct. at 232. Of course, however, the government has a right to set off claims against its creditors.

The instant case falls squarely within the rule of *Munsey Trust*, which *Pearlman* did not disturb, that the government's right to apply retained funds as a setoff against its other claims against the contractor is superior to the surety's claim against those funds.

2. Contrary to petitioner's suggestion (Pet. 7), there is no conflict between the decision below and *Western Cas. & Sur. Co.* v. *Brooks*, 362 F. 2d 486 (C.A. 4). There, the contractor was not indebted to the government and, hence, the government was a mere stakeholder. Petitioner points to no court of appeals decision refusing setoff to the government in favor of a payment bond surety.[2]

3. Petitioner contends (Pet. 10-11) that "[u]nder the literal language of the Federal Tax Lien Act of 1966, 26 U.S.C. § 6323, a payment-bond surety is granted priority over a Federal tax lien" (Pet. 10). However, petitioner overlooks the fact that in the

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[2] In *Home Indemnity Co.* v. *United States*, 313 F. Supp. 212 (W.D. Mo.), which petitioner also cites, the district court improperly disallowed a tax setoff where the surety was proceeding under a payment bond, on the ground that the government's general right to setoff, which the court conceded was established by *Munsey*, "does not include the right of the United States to set-off taxes owing to the United States" (*id.* at 216). See the discussion of *Home Indemnity* in *Aetna Insurance Co.* v. *United States*, 456 F. 2d 773, 777 (Ct. Cl.).

instant case the federal claim is bottomed not on the tax lien statute but on a common law creditor's right to setoff. Enactment of 26 U.S.C. 6323 did not grant priorities to other creditors which affect or limit this right.

The legislative history of the Act shows that Congress did not intend to change the rule of *Munsey Trust*. The relationship of the Act to the *Munsey Trust* rule, which petitioner suggests was legislatively abrogated, was stated by the Treasury Department in the course of Congressional hearings as follows:

> * * * [N]othing in this bill is intended to reverse *U. S.* v. *Munsey Trust Co.* (1947), 332 U.S. 234, which held that the United States may set off amounts due it for taxes against amounts owned [sic] by the United States to the taxpayer under a contract. [Hearings before the House Committee on Ways and Means on H.R. 11256 and H.R. 11290, 89th Cong., 2d Sess. 48.]

The relevant committees of both houses, after ordering this statement included in the records of their respective proceedings, noted in their final reports that the Treasury Department urged that the bill be adopted. H. Rep. No. 1884, 89th Cong., 2d Sess. 3; S. Rep. No. 1708, 89th Cong., 2d Sess. 3. As the Court of Claims stated in *Aetna Insurance Co.* v. *United States*, 456 F. 2d 773, 776:

> It would certainly be extraordinary for both committees to represent to Congress that the Treasury urged the adoption of the bill if, con-

trary to the views expressed by the Assistant Secretary of the Treasury, there was any intent on the part of either committee to reverse the holding in *Munsey Trust*.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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